
SEC Reaffirms Support of Convergence of Global Accounting Standards

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On February 24, 2010, the Securities and Exchange Commission published its "Commission Statement in Support of Convergence and Global Accounting Standards"¹ to reaffirm its commitment to convergence of U.S. Generally Accepted Accounting Principles ("U.S. GAAP") and International Financial Reporting Standards ("IFRS") and to outline its plan for further consideration of adoption of IFRS for U.S. reporting companies. The Commissioners directed the SEC Staff to execute a work plan (the "Work Plan") in order to position the Commission to make a determination in 2011 regarding the adoption of IFRS. The SEC indicated that, should it vote to adopt IFRS, the earliest U.S. issuers would be required to report using IFRS would be approximately 2015 or 2016; however, the Commissioners have tasked the Staff to further analyze this timeline.

I. Background

A. The Convergence Process

The SEC issued its Statement against the backdrop of an ongoing "convergence" project for U.S. and international accounting standards—i.e., for the standard setters for each system to seek to develop and implement common standards. In 2002, the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB") began to work towards the goal of converging U.S. GAAP and IFRS. A 2002 memorandum of understanding issued by the two organizations set forth the goal of developing a single set of high-quality global accounting standards. In 2006, the two organizations updated the 2002 memorandum to improve the convergence process. The 2006 memorandum was updated again in 2008 to pinpoint certain convergence projects that the FASB and IASB believed were essential to the convergence process. A recent G-20 meeting requested that the FASB and IASB continue with the convergence process with a goal completion date of 2011. To this end, in November 2009, the FASB and the IASB reaffirmed their commitment to improve IFRS and U.S. GAAP and bring about their convergence by intensifying efforts to complete the projects described in the 2006 memorandum in 2011. In addition, the FASB and the IASB stated their desire to improve efficiency and effectiveness in the convergence process by agreeing to monthly meetings and quarterly progress reports on convergence projects.

B. Roadmap for Adoption of IFRS by IASB for U.S. Companies

The Statement also builds upon the SEC's Roadmap for the adoption by all U.S. issuers of IFRS as published by the IASB, which was adopted by the Commission at a meeting on August 27, 2008.² At the meeting and in its November 14, 2008 Roadmap Release, both Commissioners and the SEC Staff emphasized the importance of developing high-quality global accounting standards. The SEC stated that it believed IFRS has the potential to become the global accounting standard, which will benefit investors, issuers and markets alike, by providing comparability among companies across the globe. In addition, the SEC said, during the coming years, as IFRS becomes the dominant accounting regime, U.S. GAAP will be marginalized if the U.S. does not move towards the implementation of IFRS. This could make foreign investors less likely to consider investments in U.S. companies. On the other hand, according to the SEC, the implementation of IFRS would assist companies by reducing the cost of capital and better facilitate cross-border investment.³

The Roadmap proposed a timeline by which the SEC would decide in 2011, based on whether certain milestones are met, whether to mandate filing by U.S. companies in IFRS beginning with their 2014 fiscal year financial statements. The Roadmap Release also discussed specific milestones that the SEC would review in deciding whether to mandate conversion to IFRS. It also considered permitting certain companies to "early adopt" IFRS before 2014.

The SEC received over 200 comment letters regarding the Roadmap during a comment period that ended in April 2009. Partly in response to concerns raised in the comment letters, the Commissioners voted to release the Statement and implement the Work Plan.

II. The Statement and Work Plan

The Statement affirms the SEC's belief in the importance of a single set of high-quality globally accepted accounting standards, that such standards will benefit U.S. investors, and that such standards are consistent with the SEC's mission of "protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation."⁴ The SEC noted that it had released the Roadmap to provide a possible path for IFRS to become that set of accounting standards; however, the response to the Roadmap identified factors that the SEC should consider in moving forward in its evaluation of whether and how to adopt IFRS. To that end, the SEC released the Work Plan along with the Statement in order to "enhance both understanding of the Commission's purpose and public transparency in this area."⁵ The SEC believes that execution of the Work Plan, in conjunction with the completion of the convergence projects of FASB and IASB, will allow the SEC to make a decision regarding adoption of IFRS in 2011.

The Work Plan provides that the Staff will analyze six different areas, the first two of which are considered the most relevant for the purposes of a future determination by the SEC to adopt IFRS, and the remaining four of which are considered transitional issues that will allow the Staff "to better evaluate the scope of, timing of, and approach to changes that would be necessary to effectively incorporate IFRS into the financial reporting system for U.S. issuers, should the SEC determine in the future to do so."⁶ The six key areas are:

- **Sufficient Development and Application of IFRS for the U.S. Domestic Reporting System.**

The SEC observes that "IFRS has the greatest potential of providing a common platform for capital markets regulators."⁷ However, the SEC notes that there are areas where IFRS may need further improvement. In addition, as stated in the Roadmap, the SEC is to consider whether the standards as established are "of high quality and sufficiently comprehensive."⁸ Under the Work Plan, the Staff will look at the development of IFRS in the following areas:

- Comprehensiveness of IFRS;
- Auditability and enforceability of financial statements prepared under IFRS; and
- Consistent and high-quality implementation of IFRS on a global basis.

– **The Independence of Standard Setting for the Benefit of Investors.**

Of significant concern is the question of whether the "accounting standard setter's funding and governance structure support the independent development of accounting standards for the ultimate benefit of investors."⁹ The Staff will conduct an ongoing review of the governance structure of the IASB, including oversight by the IFRS foundation and the composition of both the IFRS foundation and the IASB, and the IASB's efforts to secure a stable funding source.

– **Investor Understanding and Education Regarding IFRS.**

The SEC states that in order for IFRS to provide for improved comparability of financial information, investors must understand and have confidence in the financial reporting system. Through the Work Plan, the Staff will seek to gain insight into investors' understanding of IFRS and actions that need to be taken to increase investors' understanding.

– **Examination of the U.S. Regulatory Environment that Would be Affected by a Change in Accounting Standards.**

The SEC understands that the adoption of IFRS would have significant effects on financial reporting by U.S. issuers for other purposes. The Staff will study and consider the regulatory effect of adoption of IFRS in the following areas:

- The manner in which the SEC fulfills its mission, in particular how to incorporate IFRS into its rules, regulations and staff guidance, and also the potential shift from private sector standard setting bodies (such as FASB) to the IASB.
- The effect on other U.S. regulators and issuers subject to those regulators' compliance requirements, where regulators rely on SEC reported financial information.
- The impact on application of federal and tax regulations and on issuer compliance with those regulations.
- How changing SEC accounting standards to IFRS would affect the application of statutory dividend and stock repurchase restrictions.
- The effect of a change in accounting standards on auditing standard-setting and auditor requirements, in particular on the Public Company Accounting Oversight Board. In this regard, the Staff highlighted the potential impact of adoption of IFRS on

auditors' ability to audit litigation contingencies.

- Whether IFRS should be adopted for broker-dealer and investment company reporting and the effects of including, or excluding, these entities from IFRS.
- The impact of adoption of IFRS for public companies on private companies that would remain subject to U.S. GAAP.

– **The Impact on Issuers, Both Large and Small, Including Changes to Accounting Systems, Changes to Contractual Arrangements, Corporate Governance Considerations, and Litigation Contingencies.**

The SEC acknowledges that adoption of IFRS will result in significant costs to many U.S. issuers and that smaller companies without international operations will bear these costs differently than large, international companies. The Staff will evaluate the impact of logistical changes that issuers would need to implement IFRS in the following areas:

- Changes in accounting systems and procedures to identify, collect, analyze and report financial information and the corresponding controls.
- Effects on contractual arrangements entered into by U.S. issuers that require use of U.S. GAAP or are based off of current U.S. GAAP reporting.
- Corporate governance challenges, such as the need to identify audit committee financial experts with IFRS expertise, as well as to satisfy general financial literacy requirements.

The Work Plan will also consider the effect of adopting IFRS on the following:

- The effects of adoption of IFRS on accounting and disclosure requirements in the U.S. legal environment, in light of concerns about IFRS' potential use of a lower recognition threshold than U.S. GAAP and its requirements to make additional disclosures in the treatment of litigation loss contingencies.¹⁰
- Potential disproportionate impact on smaller public company issuers versus larger issuers.

– **Human Capital Readiness.**

The adoption of IFRS would require the numerous parties involved in the financial reporting process, such as investors, preparers, auditors, regulators, and academics, to attain greater familiarity with IFRS. The Staff will review the effect of adoption of IFRS on the education and training of professionals involved in the financial reporting process. It will also consider issues relating to the capacity of auditors to audit IFRS financial statements.

The Statement also addresses the possibility raised in the Roadmap of early adoption of IFRS. While the SEC does not rule out early adoption as a possibility, it is not currently pursuing rulemaking that would allow for early adoption of IFRS.

In the Statement, the SEC also addresses questions about the future role of the FASB. The SEC believes that, as in other countries that have maintained a national standard setter after incorporation of IFRS, FASB will continue to play a critical and substantive role in achieving the goal

of global accounting standards. The Staff will continue to analyze the FASB's role should IFRS be adopted.

The SEC intends that public progress reports regarding the findings of the Staff in conjunction with its carrying out of the Work Plan will be released no later than October 2010 and frequently thereafter.

III. Conclusion

There has been some uncertainty about the current SEC's views about adoption of IFRS, due to the change in leadership at the SEC and the passage of time since release of the Roadmap. The SEC's Statement has addressed some of these questions and may be a significant step towards the eventual adoption of IFRS for use by U.S. issuers for financial reporting. The Statement affirms the SEC's belief in the desirability of a single set of high-quality globally accepted accounting standards, and its view that IFRS can provide those standards. However, the Work Plan released in conjunction with the Statement identifies many areas that require a great deal of work in order to move forward on the adoption process. The October 2010 report should provide the next window into the SEC Staff's views regarding the progress of the Roadmap towards adopting IFRS. It remains to be seen whether the SEC will meet its objective of deciding by 2011 whether to adopt IFRS for U.S. public reporting companies.

¹ "Commission Statement in Support of Convergence and Global Accounting Standards," Release No. 33-9109 (February 24, 2010), [available here](#) ("Statement").

² "Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers," Release No. 33-8982 (Nov. 14, 2008) [73 FR 70815 (Nov. 21, 2008)], [available here](#) ("Roadmap Release").

³ Roadmap Release at 9.

⁴ Statement at 1.

⁵[Id.](#) at 2.

⁶[Id.](#) at 15.

⁷[Id.](#) at 16.

⁸[Id.](#) at 17, quoting Roadmap release.

⁹[Id.](#) at 19.

¹⁰ The IASB has had pending since 2005 a proposed modification to IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, which would effect changes in the standards for recognition and

disclosure of litigation contingencies and would depart substantially from applicable U.S. GAAP. Recently, the IASB reexposed certain aspects of the proposal and announced that it expected to complete the standard in 2010. See IASB News Release (Jan. 6, 2010), [available here](#).

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